PRIVATE SECURITIES LITIGATION CONFERENCE/Passage

SUBJECT: **Conference report to accompany the Private Securities Litigation Reform Act of 1995 . . . H.R. 1058. Agreeing to the conference report.**

ACTION: CONFERENCE REPORT AGREED TO, 65-30

SYNOPSIS: The conference report to accompany H.R. 1058, the Private Securities Litigation Reform Act, will enact changes to current private securities litigation practices in order to discourage unjust suits and to provide better information and protection from fraud for investors. Details are as follows:

- brokers or dealers will be prohibited from soliciting or receiving any type of fee or remuneration for helping an attorney in obtaining representation of a customer in private actions;
- a court will determine if attorneys may be barred from representing a client in a securities lawsuit if their ownership of stock subject to that suit creates a conflict of interest of if another conflict of interest exists that is sufficient to justify barring their representation;
- it will generally be prohibited to pay attorney's fees from disgorgement funds;
- each plaintiff who seeks to serve as a representative in a class action lawsuit will have to present a sworn certification of several factors, including that he or she was not hired by a lawyer to file suit and that he or she will not receive a bonus for serving as a class representative;
- a class representative's recovery in a suit will be limited to his or her pro rata share of the settlement or final judgment (though this section will not bar a court from awarding reasonable costs and expenses, including lost wages, directly related to representation);
- the filing of settlements under seal will be prohibited unless "good cause" is shown;
- attorney fees awarded by a court to counsel for a plaintiff will be limited to a "reasonable" percentage of the amount of recovery for the class;
- for any proposed or final settlement agreement to a class action lawsuit, the class will have to be informed: of the amounts of damages that the settling parties believe will be collected, on a per-share basis (if there is disagreement each party will have to state

(See other side)

YEAS (65)

Republicans (46 or 92%)		Democrats (19 or 42%)
Abraham	Helms	Baucus
Ashcroft	Hutchison	Bingaman
Bennett	Inhofe	Dodd
Brown	Jeffords	Exon
Burns	Kassebaum	Feinstein
Campbell	Kempthorne	Ford
Chafee	Kyl	Harkin
Coats	Lott	Johnston
Cochran	Lugar	Kennedy
Coverdell	Mack	Kerry
Craig	McConnell	Kohl
D'Amato	Murkowski	Lieberman
DeWine	Nickles	Mikulski
Dole	Pressler	Moseley-Braun
Domenici	Santorum	Murray
Faircloth	Simpson	Pell
Frist	Smith	Reid
Gorton	Snowe	Robb
Grams	Stevens	Rockefeller
Grassley	Thomas	
Gregg	Thompson	
Hatch	Thurmond	
Hatfield	Warner	

NAYS (30)

Republicans (4 or 8%)	Democrats (26 or 58%)
Cohen	Akaka
McCain	Biden
Shelby	Boxer
Specter	Breaux
	Bryan
	Bumpers
	Byrd
	Conrad
	Daschle
	Dorgan
	Feingold
	Glenn
	Graham
	Heflin
	Hollings
	Inouye
	Kerrey
	Lautenberg
	Leahy
	Levin
	Moynihan
	Nunn
	Pryor
	Sarbanes
	Simon
	Wellstone

NOT VOTING (3)

Republicans (2)	Democrats (1)
Gramm-[2]	Bradley-[2]
Roth-[2]	

VOTING PRESENT(1)
Bond

EXPLANATION OF ABSENCE:
1—Official Buisiness
2—Necessarily Absent
3—Illness
4—Other

SYMBOLS:
AY—Announced Yea
AN—Announced Nay
PY—Paired Yea
PN—Paired Nay

the amount it believes will be collected); any intention to use part of the award to pay legal fees; the reason for any proposed settlement; and other specified information;

- after a complaint is filed, it will be published so that members of the purported class may learn of the complaint and, within 60 days, apply to be lead plaintiff;
- a rebuttable presumption will be established that the plaintiff with the largest financial stake in an action should be named lead plaintiff (see vote No. 287 for related debate);
- the lead plaintiff will select the lead counsel;
- upon final adjudication of a private securities action, a judge will review the record for compliance with rule 11 of the Federal Rules of Civil Procedure (which bars frivolous, harassing, and other legal maneuvers), and will assess appropriate penalties; if an initial pleading is in substantial violation,a plaintiff may have to pay the legal fees for the entire action (see vote No. 291 for related debate);
- discovery will generally be stayed upon a motion to dismiss (see vote No. 292 for related debate);
- plaintiffs alleging untrue statements of material facts, or the omission of material facts necessary to keep statements from being misleading, will specify in their pleadings the statements and omissions forming the basis of their allegations, and why they believe their allegations are true;
- to make pleadings based on the defendant's state of mind, a plaintiff will have to allege facts with particularity that give strong inference that the defendant acted with the required state of mind;
- a safe harbor from securities litigation will be created for forward-looking statements, whether written or oral, that are accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially (the "bespeaks caution" test); numerous exemptions from this safe-harbor, mostly for certain types of businesses, will be made (for related debate, see vote Nos. 288-289 and 294);
- in private actions, defendants will have the right to a written interrogatory for each allegation based on their state of mind;
- application of the Racketeer Influenced and Corrupt Organizations (RICO) Act to securities suits will be limited;
- the SEC will be given statutory authority to prosecute knowing aiders and abettors of securities fraud who provide substantial assistance in committing that fraud (see vote No. 286 for related debate);
- a defendant will not have to pay damages to a plaintiff for losses unrelated to misstatements or omissions which caused a securities loss;
- a study will be done of the protection senior citizens are afforded by this Act from securities fraud (see vote No. 285);
- in general, in actions seeking damages in reference to the market price of a security, a plaintiff's damages will not exceed the difference between the purchase or sale price, as appropriate, by the plaintiff for the security and the median market price in the 90 days after the defendant corrects the misstatement or omissions;
- joint and several liability will be retained for defendants who "knowingly" commit securities fraud, but a modified proportionate liability standard will be applied to defendants who are found guilty of "reckless" conduct (the proportionate liability standard is the same as in the Senate-passed bill; see vote No. 284 for related debate);
- plaintiffs may be required to post bonds in case their actions are ruled frivolous and they consequently have to pay defendant's costs; and
- independent public accountants will be required to notify a company's management of any illegal activity they discover, and if the management fails to act, they will be required to notify the company's board of directors, and if the board of directors fails to notify the SEC within 1 day, the accountants will be required to notify the SEC the following day.

Those favoring final passage contended:

The conference report is very similar in substance to the Senate-passed bill (see vote No. 295), which passed by an overwhelming margin. We are therefore confident that this bill will pass by an equally wide margin. Perhaps the most substantive change was to the safe-harbor standard for forward-looking statements. Some Senators have said that this change will result in a standard that protects fraud, but we note for them that the Securities and Exchange Commission believes that this change is beneficial and has endorsed the definition. Another change is that the bill does not include the specific evidentiary standards for a court to use in evaluating a defendant's state of mind that were in the Senate-passed bill. We know that many Senators are disappointed that those standards were not included, but all conference reports are a product of compromise, and though the Senate did not prevail on this issue, we remind them that on most points this bill is much closer to the Senate-passed bill than the House-passed bill.

Overall, this bill is good for America and bad for the approximately 90 lawyers who are guilty of filing frivolous securities litigation suits. Twenty or thirty years ago these few unethical lawyers would have been disbarred for committing champerty, which is the pursuit of litigation by lawyers that is more beneficial to them than their clients. The judges of yesteryear would not have tolerated lawyers advertising nationwide for clients and then keeping an average 86 cents on the dollar for themselves and their investigators. Today, though, judges accept a body of case law that has slowly developed that permits disreputable, sleazy lawyers to extort money for themselves from innocent corporations by making baseless allegations of fraud. As one of these buccaneer

barristers recently crowed in Forbes magazine, "I have the greatest practice in the world. I have no clients."

The common practice of this small number of lawyers is to file class action suits alleging hundreds of millions of dollars of fraud. The suits name defendants according to their wealth; any company with money, no matter how peripherally related to a suit, is named. In 93 percent of the cases, companies then settle for a few million dollar payment, with most of the money going to the lawyers, and a small sum going to the class the lawyers pretended to represent. Usually, the lead plaintiff will be a small investor who is paid by lawyers for the right to file a class action suit on his or her behalf. That small investor usually gets a bonus from the lawyers. If companies do not settle, they must spend millions of dollars in defending themselves. Most of those costs are due to discovery, which requires them to turn over reams of documentation to any lawyer who accuses them of fraud. The lawyers then pick through the documents hoping to find some little detail they can distort before a jury. Juries, for their part, will almost always rule against the plaintiffs. However, even the most frivolous suits sometimes succeed, because juries will misapply the law, especially in complex areas such as securities litigation. Juries are especially prone to misapply the law in securities cases because the law has never actually been written--it exists almost entirely as a court-created right, that varies from jurisdiction to jurisdiction and that even varies from case to case within a jurisdiction. A company that is threatened with a several hundred million dollar lawsuit, no matter how baseless, will not usually fight it and risk the 5 percent to 10 percent chance that it will lose and be bankrupted.

The purpose of our securities laws is to provide investors with timely and accurate information on public companies so that they may make informed decisions on their securities transactions. Clearly the current system is not working. A few lawyers make millions on frivolous suits, growing companies are unwilling to provide information on their operations for fear of being sued, large companies refuse to associate with smaller companies for fear of being named as partners in unjust suits, and even in legitimate suits lawyers rip-off their clients by settling quickly for millions of dollars for themselves and only pennies on the dollar for the real losses suffered by their clients. Investors are severely hurt because they do not get timely and accurate information, plus, when they are victims of fraud, they are not compensated.

This bill will totally reform the current system. Starting from the filing of a suit, several measures will be enacted that will make sure that the suit is not frivolous. Those measures include that it will be illegal for brokers to provide lists of investors to lawyers or to pay a pet lead plaintiff a bonus to represent it. Further, every class action suit will be advertised so that class members will have a chance to join, and a rebuttable presumption will exist that the plaintiff with the greatest financial interest (generally an institutional investor representing tens of thousands of clients) should be the lead plaintiff. Next, the bill will take steps to make sure that only those who are guilty of fraud will be pursued in securities cases. For instance, a safe harbor will be created for forward-looking statements. Just as importantly, the bill will not undo the Supreme Court ruling that no private right of action exists for alleging aiding and abetting (this weak standard has been heavily abused by lawyers to sue large companies that have tenuous connections with smaller companies that they have accused of committing fraud). Finally, when a suit is settled, the reforms that will be made by this bill include that the liability of defendants who are only peripherally involved will be limited, that lawyers will have to disclose their settlements, that attorneys' fees will be limited, and that any judgment will be fairly distributed among the plaintiffs on a pro rata basis.

The reforms in this bill are strongly supported by both investors and businesses. In fact, we do not know of any opposition that does not come from lawyers, newspaper editorialists, and government regulators. The last group is certainly not united in opposition; we have endorsements from the pension fund administrators and regulators of many States. Many investors, in fact, view this bill as too modest.

In addition to the usual suspects (lawyers, pundits, and bureaucrats) who are opposed to this bill, our colleagues also claim that we should list the elderly. They are wrong. In March, 1995, the National Investor Relations Institute commissioned a poll of Americans age 50 and over who invest in either stocks or mutual funds. That poll found the following: 87 percent think that securities lawsuits divert scarce funds that can be used on product research and business expansion; 79 percent believe that defendants should only pay damages according to their percentage of fault; and 81 percent favor making a lawyer who files a frivolous suit pay the legal fees of both sides. Seventy percent of the poll respondents also said at least one member of their household was a member of AARP, which opposes this bill. Our colleagues' only evidence for saying that senior citizens oppose this bill is that AARP opposes it; we suggest that they should worry more about what senior citizens themselves want instead of what a special interest group that is clearly out of touch with its membership says they want.

All of the major investment organizations, 10 of the biggest public pension funds, 12 State pension fund administrators and regulators, and hundreds of companies have all expressed support for this bill. Both plaintiffs (investors) and defendants (the businesses that are owned and directed by investors) want Senators to pass H.R. 1058 to give them protection from rapacious lawyers. We will not disappoint them.

Those opposing final passage contended:

From the beginning of the debate on this bill we have been willing to concede that some frivolous securities suits are filed, and we have concurred that steps should be taken to stop those suits. However, this bill will do far more than block frivolous suits; it will make it so difficult to sue for legitimate reasons that it will virtually give unscrupulous individuals a license to steal. This is a Trojan

Horse bill; on the outside, its stated purpose is reasonable, but its inner details are full of nasty surprises.

For the last 6 decades the United States has enjoyed the world's safest securities markets. These markets have not been crippled by a litigation explosion; in the past 20 years, the amount of capital they attract has increased tremendously, while the number of suits filed has remained steady at about 300 per year. To further illustrate how minor the problem is, we inform our colleagues that there are some 14,000 companies that have filings with the SEC, but each year only about 140 out of those 14,000 are brought in as party defendants in class action suits.

To eliminate the few cases out of the 300 or so that are filed each year that are frivolous, our colleagues have so limited the right to file suit that it will not only discourage frivolous suits, it will also make it nearly impossible to win legitimate suits. The bill will fail to overturn the 1-year/3-year statute of limitations that the Supreme Court unwisely set last year as the national standard; it will surrender control of class action suits to the wealthiest member of the class (who frequently is a party to the fraud that is the subject of the suit); it will create a safe harbor for forward-looking statements that will protect deliberate lies (the provision in the conference report is even worse than the Senate-passed bill); it will not give private parties the right to sue aiders and abettors; it will limit RICO liability; and it will overturn hundreds of years of tort law precedence by sharply limiting the doctrine of joint and several liability for damages. These and other changes will create a simple, "buyer beware" investment system that will lead to massive fraud. Human nature being what it is, if people know they can legally get away with defrauding investors, they will. Just as deregulation of the thrift industry contributed to its massive failure, we fear that this bill will cause such widespread fraud that a several-hundred-billion-dollar bailout will be needed in a few years.

We should not go through such an exercise. The current system needs only a few minor tweaks to get rid of frivolous suits; the right of defrauded investors to sue does not need to be discarded. Fifty major newspapers, literally every legal group involved in securities fraud litigation (both public and private) and senior citizens are solidly opposed to this bill, and for good reason: it will promote fraud. Unfortunately, though, the die is cast; we will vote against this conference report, but we know a majority of Senators will vote in its favor and send it to the President. All we can hope for now is that President Clinton will veto it.